

Internal Revenue Service
memorandum

CC:TL-N-728-89
Br2:SMJannotta

date: DEC 07 1988

to: District Counsel, Des Moines CC:DM
Attn: Christopher J. Faiferlick, Attorney

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

Your ref: CC:DM-TL-N-8771-88

This responds to your request for technical advice dated October 21, 1988. Although the request was framed in terms of a specific taxpayer situation, subsequent discussion clarified that the underlying I.R.C. § 6045 issue was submitted because of its broader applicability and concern to the Examination Division in a number of other cases as well. Accordingly, we have considered your request as one for generalized technical advice rather than one for advice in a particular situation. If particular advice is required by Examination in any case in inventory, it should be sought directly from the Associate Chief Counsel (Technical) in accordance with the procedures established by Rev. Proc. 88-2, I.R.B. 1988-1, p. 21.

ISSUE

Whether a closely-held corporation is a "broker" for purposes of I.R.C. § 6045 when it regularly redeems its own stock and/or repurchases its own debentures in accordance with the terms of its original offering.

CONCLUSION

Where a closely-held corporation regularly redeems its own stock or regularly retires its own debt, that corporation is a "broker" within the meaning of I.R.C. § 6045 and Treas. Reg. § 1.6045-1(a). Whether a Form 1099-B (or magnetic media filing) is actually required to be filed, however, turns on whether the particular transaction involves a "sale" (including a redemption of stock or retirement of indebtedness) by a "customer" (including an officer, employee or shareholder of the corporation) of "securities" (including shares of stock or debt obligations) for cash. See Treas. Reg. § 1.6045-1(c)(2).

08855

FACTS

According to information contained in your request for advice, the salient facts are as follows. A closely-held corporation offers shares of its common stock and debt instruments to its employees under terms which restrict their ability to subsequently dispose of such assets. With respect to the common stock, the corporation retains a right of repurchase for ten years once the stock becomes transferable.¹ If the corporation exercises its repurchase option, it must utilize a formula which sets the minimum (but not the maximum) number of shares it can reacquire in that year. To the extent the corporation does not exercise its repurchase option in any year, the shareholder may offer for sale (or otherwise dispose of) at most the same number of shares the corporation would have been required to purchase had it exercised its repurchase option that year. For purposes of our analysis, we assume that the corporation's conduct over a period of years with respect to the redemption of its stock is sufficient to establish the regularity of such conduct.

The corporation also offers debentures to its employees and will repurchase, at any time, the debentures at par. The debentures are offered to employees who meet state residency requirements and may be assigned subject to the corporation's repurchase agreement (the terms of which are set forth in the investment certificates). Essentially, the corporation has a ten day period in which to buy the entire amount of the proposed assignment.

ANALYSIS

I. Whether a corporation is ever a "broker" for purposes of I.R.C. § 6045.

"Every person doing business as a broker shall, when required by the Secretary, make a return, in accordance with such

¹ Generally, it appears the stock is held for capital growth investment and becomes transferable upon termination of employment. Thus, retirement, unemployment, severance of employment and death would all appear to be events which render the stock transferable. No information has been provided, and no facts have been assumed, with respect to whether such stock is also susceptible to redemption or transfer (e.g., by gift, assignment or pledge) prior to termination of employment. We have, therefore, not considered these latter transactions, if any, as part of the corporation's regular conduct in our consideration of whether the corporation would be a "broker" with respect to the "termination of employment" transactions.

regulations as the Secretary may prescribe...." I.R.C. § 6045(a). Although a broker is generally thought of as a middleman acting for a consideration, I.R.C. § 6045(c)(1)(C), the implementing regulations define a "broker" for purposes of I.R.C. § 6045 as "a person that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales to be made by others." Treas. Reg. § 1.6045-1(a)(1). A person, moreover, may still be a "broker" even though acting as a principal in the sale. See Treas. Reg. § 1.6045-1(a)(2)(ii); Treas. Reg. § 1.6045-1(a)(10). A "sale" for purposes of I.R.C. § 6045 reporting requirements is defined, in pertinent part, in Treas. Reg. § 1.6045-1(a)(9) as "any disposition of securities ... for cash, and includes redemptions of stock [and] retirements of indebtedness...." ²

In the examples provided in the regulations, it is clear that "[an] obligor [which] regularly issues and retires its own notes" would be considered a broker (emphasis added). Treas. Reg. § 1.6045-1(b)(1)(ii). Moreover, in Rev. Rul. 86-21, 1986-1 C.B. 349, the Service took the position that while a corporation's one time odd-lot purchase of its own stock did not render the corporation a broker for purposes of I.R.C. § 6045, "a corporation [was] a broker for purposes of section 6045(a) if it regularly stands ready to redeem its stock or to retire its debt" (emphasis added). Thus, as a general matter, a corporation may be a broker for purposes of the reporting requirements under I.R.C. § 6045, with respect to either redemption of its own stock or retirement of its own debt.

II. Whether the Transactions at Issue Would Constitute Reportable Sales

The implementing regulations require that "a broker shall make a return of information with respect to each sale by a customer of the broker effected by the broker in the ordinary course of a trade or business in which the broker stands ready to effect sales to be made by others." ³ Treas. Reg. § 1.6045-1(c)(2). Whether the activities of a corporation, such as the

² A security is defined in the regulation to include "[a] share of stock in a corporation (foreign or domestic)," Treas. Reg. § 1.6045-1(a)(3)(i), and "[a] debt obligation," Treas. Reg. § 1.6045-1(a)(3)(iv). "The term 'cash' means United States dollars or any convertible foreign currency." Treas. Reg. § 1.6045-1(a)(2).

³ Exceptions are provided in Temp. Reg. § 5f.6045-1 for sales effected on or after May 29, 1984, and Treas. Reg. 1.6045-1(c)(3) for sales effected before May 29, 1984.

one here, with respect to either the redemption of its stock or the retirement of its debt pursuant to terms set forth in the original offerings of such securities can be considered to be "in the ordinary course of a trade or business in which the broker [i.e., the corporation] stands ready to effect sales" is, ultimately, a factual determination in every case.

The Service has taken the position that, with respect to corporations not otherwise licensed as brokers, "[the] reference to 'trade or business' in the regulations does not require that a specific [brokerage] fee or commission be received by the [corporation] in payment for effecting a sale." LTR 84-47-036 (Oct. 10, 1984). Rather, the relevant focus of inquiry is whether the corporation holds itself out as being available to accept offers of sales of securities from its "customers" on a regular basis in the ordinary course of conducting its own trade or business. Id. In LTR 84-47-036, the factual situation involved a company which was a registered transfer agent. The company also administered its own employee stock purchase plan and an employee stock ownership plan both of which were qualified plans under I.R.C. § 401(a). The company derived no fees or commissions in connection with transactions under these plans. Upon termination of participation, an employee could request either stock or a lump-sum distribution. It was determined, on the facts presented, that the company was a broker with respect to those stockholders who were participants in its employee stock plans. Additionally, Rev. Rul. 86-21 specifically stated Service position with respect to a corporation which regularly redeems its own stock or retires its own debt, (i.e., such a corporation is a broker for purposes of I.R.C. § 6045). Therefore, consistent with Service position, we conclude that, where the corporation regularly holds itself out as ready either to redeem its stock or to retire its debt (whether pursuant to the terms set forth in its original offering or through a pattern of conduct which clearly establishes the regularity of the corporation's willingness to effect such sales), the corporation is a broker with respect to those shareholders or bondholders for whom it stands ready to effect such sales.

Once those categories of shareholders or bondholders who are deemed to be "customers" ⁴ have been identified, the focus shifts to identifying those transactions which constitute reportable sales under I.R.C. § 6045. See Treas. Reg. § 1.6045-1(c)(2). On the facts provided, it appears that a corporation, such as the one here, is acting in the ordinary course of its trade or business when it regularly effects sales for its employees ⁵ through its redemption of common stock and repurchase of outstanding debt in accordance with the terms and conditions of the original offerings.

CONCLUSION

Based on the above analysis, we conclude that a corporation is a broker for purposes of I.R.C. § 6045 with respect to its redemption of stock and/or retirement of debt from those customers for whom it regularly stands ready to effect sales of such securities for cash. Thus, on the facts provided, we would agree that [REDACTED] was a broker with respect to those redemptions of stock from former employees which were in accordance with the terms and conditions of the original offering agreements. We would also agree that [REDACTED] was a broker with respect to those retirements of debt from current or former employees which were in accordance with the terms and conditions of the optional repurchase agreement set forth in the original investment certificates.

We recognize, however, that it is by no means certain the Service will prevail in any litigation challenging the reporting requirements on facts similar to the ones relied on here. While the Service's announced position requires a corporation to file on these facts, that position is premised on the as yet unchallenged and, therefore, presumed validity of the expansive regulatory definition of broker in Treas. Reg. § 1.6045-1(a)(1). Moreover, the language in Rev. Rul. 86-21, which most clearly states the Service's intention to include such corporations as brokers for purposes of I.R.C. § 6045 was added specifically because Treasury believed existing pronouncements (e.g., Treas.

⁴ Customer as used in I.R.C. § 6045 means "the person (other than such broker) that makes the sale...." Treas. Reg. § 1.6045-1(a)(2). It is, therefore, broad enough to encompass a corporation's officers, employees, shareholders and obligors if the "broker" (i.e., the corporation here) regularly stands ready to effect sales from such persons.

⁵ We use this term to include not only current and/or former employees but the beneficiaries of former employees as well (and, if the terms and conditions of the original offering agreements require, the trustees for any such deceased employees' estates).

Reg. § 1.6045-1(b)(i)(ii)) were not clear enough "given the arguable ambiguity of the regulations and the tremendous potential liability for failing to comply." Memorandum, dated January 6, 1986, from Tax Legislative Counsel Mikel M. Rollyson to Associate Chief Counsel (Technical) Charles M. Morgan, III, p. 2. Consequently, we believe it may be difficult for a court to sustain the Service's imposition of filing requirements under I.R.C. § 6045 on facts such as these (especially with respect to a corporation's redemption of stock) at least for returns due prior to publication of Rev. Rul. 86-21 in I.R.B. 1986-7 on February 18, 1986.

If we can be of further assistance, please call Attorney Santina M. Jannotta at (FTS) 566-3520.

MARLENE GROSS

By:



JUDITH M. WALL
Senior Technician Reviewer
Branch No. 2
Tax Litigation Division